MARKFAITH INVESTMENT LTD.

v.

CHIAP HUA FLASHLIGHT LTD.

COURT OF APPEAL, HONG KONG
LORD KEITH OF KINKEL
LORD BRANDON OF OAKBROOK
LORD TEMPLEMAN
LORD GOFF OF CHIEVELEY
LORD LOWRY
[PRIVY COUNCIL APPEAL NO. 28 OF 1989]
8 MARCH 1990

LAND LAW: *Sale of head lease - Contained an option to renew for two years - Purchasers declined to complete sale subject to option - Whether an option in an unregistered lease is binding on a purchaser - Section 3(2) of the Land Registration Ordinance - Protects a bare lease for a term not exceeding three years - Not apt to protect an option to renew in on unregistered lease.*

By a sale agreement dated 31 March 1988 the respondent vendors, Chiap Hua Flashlights Ltd., contracted to sell to the appellant purchasers, Markfaith Investment Ltd., for HK$100,000,000 a registered crown lease. Clause II of the sale agreement provided that the premises were sold subject to tenancy agreements which contained an option to renew for two years.

By inadvertence, later corrected, the vendors did not inform the purchasers of the option. The tenancy agreements were not registered on 18 April 1988 when the purchasers registered the sale agreement.

The purchasers declared to complete the sale on the grounds that the purchasers were entitled to an assignment free from the options to renew.

The issue was whether under the Land Registration Ordinance, an option to renew contained in an unregistered lease was binding on a purchaser of the reversion.

Held:

Section 3(2) of the Land Registration Ordinance rendered the options to renew contained in the unregistered tenancy agreements void against the purchasers as soon as the purchasers registered their sale agreement on 18 April 1988.

[Their Lordships will humbly advise Her Majesty that their appeal should be dismissed. The appellant must pay the respondent's case.]

Cases referred to:

Woodall v. Clifton [1905] 2 Ch 257
Beesly v. Halwood Estates Limited [1960] 1 WLR 549
Helby v. Matthews [1895] AC 471
Hollington Brothers Limited v. Rhodes [1951] 2 TLR 691
Re Monolithic Building Company [1915] 1 Ch 643
Edwards v. Edwards [1876] 2 Ch D 291
Eyre v. McDowell [1861] 9 HLC 619
Jones v. Barker [1909] 1 Ch 321

Kwok Siu Lau v. Kan Yang Che [1913] 8 HKLR 52
Chung Khiaw Bank Ltd. v. United Overseas Bank Ltd. [1970] AC 767
Security Trust Co. v. Royal Bank of Canada [1976] AC 503

Legislation referred to:
Irish Act 13 and 14 [Ireland], s. 7
Land Charges Act 1925 [UK], s. 13(2)
Land Registration Ordinance (Cap 128) [HK], ss. 2, 3(2), 4
Law of Property Act 1925 [UK], s. 199

JUDGMENT

Lord Templeman:

The question is whether, under the Land Registration Ordinance (Cap. 128) of Hong Kong as amended, an option to renew contained in an unregistered lease is binding on a purchaser of the reversion.

The Ordinance in its original form was enacted on 28 February 1844. Nothing turns on the amendments. The Ordinance recites that:

> It is expedient to prevent secret and fraudulent conveyances ... and to provide means whereby the title to real and immovable property may be easily traced and ascertained.

Prior to the date of the Ordinance the proof and transmission of title to land in England and in Hong Kong were obstructed by legal and equitable encumbrances resulting from conveyances, leases, mortgages, rent charges, settlements, wills and other documents. Section 2 of the Ordinance provides for registration in the land office of:

> ... deeds, conveyances, and other instruments in writing, and wills and judgments, ... by which ... any parcels of ground, tenements, or premises in Hong Kong may be affected ...

Section 3(2) of the Ordinance stipulates that:

> (2) All such deeds, conveyances, and other instruments in writing, and wills and judgments ... which are not registered shall, as against any subsequent *bona fide* purchaser or mortgagee for valuable consideration of the same parcels of ground, tenements, or premises, be absolutely null and void to all intents and purposes:
>
> Provided that nothing herein contained shall extend to *bona fide* leases at rack rent for any term not exceeding 3 years.

By a sale agreement dated 31 March 1988 the respondent vendors, Chiap Hua Flashlights Limited, contracted to sell to the appellant purchasers, Markfaith Investment Limited, for HK$100,000,000 a registered crown lease of a parcel of ground at Kowloon together with the buildings thereon. Clause 11 of the sale agreement provided that the premises were sold "subject to such tenancy agreement as specified in schedule II hereto". That schedule mentioned thirteen lettings each of which was less than three years in duration. By inadvertence, later corrected, the vendors did not inform the purchasers that ten of the tenancy agreements contained an option to renew for two years "at agreeable rental six months before expiry". The tenancy agreements were not registered when on 18 April 1988 the purchasers registered the sale agreement. The purchasers declined to complete the sale by accepting an assignment of the vendors' Crown lease of the premises, "subject to the existing lettings and tenancies thereon", on the grounds that the purchasers were entitled to an assignment free from the options to renew. The Court of Appeal (Cons V.-P., Kempster and Clough JJA) decided that the options to renew were void against the purchasers because the tenancy agreements had not been registered under the Ordinance before 18 April 1988. The Court of

Appeal therefore confirmed, on a ground not argued before the trial Judge, the declaration made by Godfrey J that the sale agreement had been rescinded, that the purchasers' deposit had been forfeited and that the vendors were entitled to damages (if any) for the purchasers' breach of contract in refusing to complete.

On behalf of the purchasers, Mr. McDonnell argued that the tenancy agreements were not registrable in respect of the options to renew because the tenancy agreements were leases at rack rents for terms not exceeding three years saved from registration by the proviso to s. 3(2) of the Ordinance. Their Lordships concur with the Court of Appeal in rejecting this argument. The Ordinance facilitates the tracing and ascertainment of title by enabling a purchaser to ignore any encumbrance which is not registered other than a short lease at a rack rent. The tenant of a short lease at a rack rent is not put to the bother and expense of registration. The purchaser has no need to concern himself, before or after contract, with a short lease at a rack rent unless the purchaser requires to obtain vacant possession on a particular date before the residue of a three year term will expire. If the argument put forward by the purchasers were correct a four years lease would be void for non-registrable but a perpetual right of renewal contained in an unregistered lease for three years would be valid.

The proviso to s. 3(2) applies to a "lease" and not to an "instrument in writing" and is only apt to protect a bare lease for a term not exceeding three years. The proviso is not apt to protect a further term which will only be granted if the tenant exercises an option created by the instrument which also created the lease. The original term is saved because it is a lease for a term not exceeding three years. The option will not take effect as against a *bona fide* purchaser of the reversion for valuable consideration because in the absence of registration the instrument which creates the option is null and void. The proviso to s. 3(2) applies to an instrument insofar as that instrument creates a lease at a rack rent for a term not exceeding three years. The proviso does not apply to an instrument insofar as the instrument creates an option.

Mr. McDonnell relied on the well-known passage in the judgment of the Court of Appeal delivered by Romer LJ in *Woodall v. Clifton* [1905] 2 Ch 257. In that passage Romer LJ accepted that a covenant to renew a lease ran with the reversion "though the fact that a covenant to renew should be held to run with the land has by many been considered as an anomaly, which it is too late now to question, though it is difficult to justify". A covenant which runs with the reversion is enforceable by the tenant against a purchaser of the reversion by privity of estate. But the fact that a covenant to renew runs with the reversion cannot affect the operation of s. 3(2). That section renders null and void against a purchaser of the reversion an unregistered instrument in writing but by virtue of the proviso does not render void a lease at a rack rent for a term not exceeding three years. A covenant to renew at the option of the tenant is not a lease and is therefore not protected by the proviso. In *Beesly v. Hallwood Estates Limited* [1960] 1 WLR 549 a lease for a term of twenty-one years provided that on the tenant's giving at least six months' notice in writing previous to the determination of the lease they should have the right to obtain a further lease for twenty-one years on the same conditions subject to certain amendments. Buckley J, applying the principles laid down by the House of Lords in *Helby v. Matthews* [1895] AC 471, analysed an option to renew at p. 556 as follows:

> ... the option contained in ... the lease ... did not constitute a contract, albeit conditional, by the lessor to grant a further term in the land upon the exercise by the lessees of the option: it constituted an offer to grant such a term which the lessor was contractually precluded from withdrawing so long as the option remained exercisable.

In the present case each tenancy agreement was an instrument in writing which created a lease and made an irrevocable offer to grant a further lease. The lease is preserved by the proviso to s. 3(2) of the Ordinance, but so far as the offer of a further lease is concerned, the instrument is null and void against a purchaser. On 31 March 1988 when the sale agreement was entered into and, for that matter, on 18 April 1988 when the sale agreement was registered, the purchasers were *bona fide* purchasers for valuable consideration of a Crown lease of parcels of grounds, tenements and premises in Hong Kong affected by the previous instruments in writing namely, the unregistered tenancy agreements. Those instruments in writing thereupon became and remained null and void against the purchasers except insofar as they created leases at rack rents for terms not exceeding three years.

The appeal against the decision of Godfrey J upheld by the Court of Appeal must therefore be dismissed. Mr. McDonnell, in the course of an adroit and ingenious argument, attempted to escape from this consequence by submitting that, if the purchasers had completed and had accepted an assignment, as agreed, of the vendors' reversion "subject to" the tenancy agreements, the purchasers would have been bound by the options, first, because the tenancy agreements contained the options and, secondly, because the vendors could not assign more than they possessed and they only possessed the reversion subject to the tenancy agreements. In some mysterious way, the tenancy agreements, having been rendered null and void against the purchasers on 18 April 1988 to the extent of the options for renewal, would be given a new lease of life against the purchasers by virtue of an assignment in June 1988 expressed to be subject to the tenancy agreements. The assignment was properly expressed to be subject to the tenancy agreements so far as those tenancy agreements created leases at rack rents for terms not exceeding three years which were preserve by the proviso to s. 3(2). The assignment was not expressed to be subject to any options or subject to the tenancy agreements so far as they were null and void against the purchasers.

In *Hollington Brothers Limited v. Rhodes* [1951] 2 TLR 691 a head lease was assigned by the defendant vendors to a purchaser "subject to and with the benefit of such tenancies as may affect the premises".

The plaintiffs were tenants under an agreement for a lease granted by the vendors for seven years. The agreement was never registered as a land charge. By s. 13(2) of the Land Charges Act 1925 this agreement, not having been registered as a land charge, was void "against a purchaser of the land charged therewith or of any interest in such land ...". The tenants sued the vendors for damages for breach of the covenant for quiet enjoyment in the agreement for a lease. The vendors pleaded that they were not liable in damages because the tenants could enforce the agreement against the purchaser; the purchaser did not contract to obtain and did not by the assignment get any estate in the land expressed to override the tenants' rights, and consequently the purchaser took subject to those rights which were expressly mentioned; the land purchased was in fact only an interest in the land subject to the rights of the tenants. Harman J rejected this argument. He pointed out that it was the policy of the framers of the 1925 legislation to get rid of equitable rights unless registered. After citing *re Monolithic Building Company* [1915] 1 Ch 643 and *Edwards v. Edwards* [1876] 2 Ch D 291, in which null and void was construed as meaning null and void, Harman J said at p. 696:

> Finally, as under s. 13 of The Land Charges Act ... an unregistered estate contract is void, and under s. 199 of The Law of Property Act 1925, the purchaser is not to be prejudicially affected by it, I do not see how that which is void and which is not to prejudice the

> purchaser can be validated by some equitable doctrine. There is, after all, no great hardship in this. The plaintiffs could at any time right up to the completion of the assignment ... have preserved their rights by registration ....

Section 13 of the Land Charges Act 1925 provides that a land charge shall be void against the purchaser of the land charged therewith unless the land charge is registered. Section 199 of the Law of Property Act 1925 is similar to s. 4 of the Ordinance whereby no notice actual or constructive of any prior unregistered instrument in writing shall affect the priority of any registered instrument. The present case is indistinguishable from the decision of Harman J in *Hollington Brothers Limited b. Rhodes*.

Mr. McDonnell sought to apply to the present circumstances the decision of the House of Lords in *Eyre v. McDowell* [1861] 9 HLC 619. In that case s. 7 of the Irish Act 13 and 14 Vict. c. 29 (Ir.) charged in favour of a registered judgment creditor as if by deed "all the estate and interest of which the debtor ... shall at the date of such registration be seized or possessed at law or in equity or might at such time create by virtue of any disposing power which he might then, without the consent of any other person exercise for his own benefit ...". The House of Lords concluded from this section, and from other provisions of the Act and from the history and provisions of the supplemental Act 3 and 4 Vict. c. 105 (Ir.), that the judgment creditor only became entitled to the beneficial interest of the debtor in the property charged; per Lord Cranworth at p. 649 and Lord Wensleydale at p. 652. On the facts in that case the beneficial interest of the debtor was subject to an earlier unregistered equitable mortgage and the House of Lords held that the registered judgment creditor, being entitled only to the beneficial interest of the debtor, took subject to the mortgage which was binding on the debtor. The House of Lords considered the application of the earlier Irish Act 6 Anne C2 which made unregistered dispositions fraudulent and void against registered dispositions but under that Act registration was only effective "according to the right title and interest" of the person making the disposition. "The statute of Anne therefore the question untouched"; per Lord Cranworth at p. 647 and Lord Wensleydale at p. 653. In the present case however the Ordinance is not limited to beneficial interest. Section 3(2) provides that all registrable, unregistered instruments in writing shall be absolutely null and void to all intents and purposes against any subsequent *bona fide* purchaser for valuable consideration of the same parcels of ground, tenements or premises. In the present case the tenants and the purchasers claim and compete for the same parcel of ground: the tenants claim under an unregistered instrument which is void against the purchasers. Any other conclusion is inconsistent both with the language and the obvious purpose of the Ordinance.

Mr. McDonnell also relied on *Jones v. Barker* [1908] 1 Ch 321. There again a registered assignment by a debtor of all his property to a trustee for his creditors was held to pass only the beneficial interest of the debtor in that property and accordingly the trustee, not being in a better position than the debtor, could not claim the proceeds of sale of the property without satisfying a prior unregistered equitable mortgage entered into by the debtor. Section 3(2) of the Ordinance on the other hand puts the purchaser in a better position than his vendor.

In *Kwok Siu Lau v. Kan Yang Che* [1913] 8 HKLR 52 the Court of Appeal of Hong Kong decided that the decision in *Jones v. Barker* did not apply in favour of an unregistered sub-lease against an assignee of the property held under the head lease but, obiter, opined that the decision in *Jones v. Barker* might have applied to an assignment of the reversion of the head lease. It is difficult to see how the terms of an assignment between vendor and

purchaser of a head lease could make any difference to the rights of the purchaser, against whom any unregistered sub-lease was rendered null and void by s. 3(2) of the Ordinance, or could confer any rights on the sub-lease who was not party or privy to the assignment.

In *Chung Khiaw Bank Ltd. v. United Overseas Bank Ltd.* [1970] AC 767 the Registration of Deeds Ordinance of Singapore provided that, no charge by deposit of title deeds should have any effect or priority as against any assurance for valuable consideration unless and until a memorandum was registered, and that all instruments entitled to be registered should have priority according to the date of registration. Unsecured creditors obtained an order of attachment, seizure and sale of "the interest of the judgment debtor in the land described" in the order. The debtor's interest in the land was subject to an unregistered deposit of title deeds by way of equitable mortgage. The order of attachment, seizure and sale was registered in 1966. The equitable mortgagees obtained and registered in 1967 an order against the debtor declaring that they were legal mortgagees and giving them liberty to sell. This board held that the order of attachment, seizure and sale was an "assurance for valuable consideration" within the meaning of the Ordinance and that the judgment creditors, by reason of their prior registration, were entitled to payment out of the proceeds of sale of the property in priority to the equitable mortgage. Lord Wilberforce delivering the judgment of the board, said at p. 774 that the authorities which included *Eyre v. McDowell* [1861] 9 HLC 619 and *Jones v. Barker* [1909] 1 Ch 321:

> ... lend substantial support to the contention that under the general law, apart from the special provisions of legislation as to registration, and in certain circumstances even where such special provisions exist, the judgment creditor can only take whatever interest the debtor has and that, in such a case questions of priority and correspondingly of postponement through failure to register, do not arise.

The board held, following authorities in Singapore, that the Singapore Ordinance was a special provision of legislation as to registration which placed the judgment creditors in a better position than the judgment debtor. Section 3(2) of the Hong Kong Ordinance now under discussion is also a special provision of legislation as to registration.

In *Security Trust Co. v. Royal Bank of Canada* [1976] AC 503 a vendor contracted to sell land for $900,000 and to accept a mortgage of the land for $700,000 as part of the purchase price. The conveyance and the mortgage were executed and held by the vendor in escrow pending the payment by the purchaser of the balance of the purchase price namely $200,000. The purchaser, a company, executed a debenture charging its property present and future to a creditor of the company and providing for a fixed first charge on the purchaser's present freehold property. The debenture was registered. Subsequently a receiver appointed by the debenture holder advanced out of money provided by the debenture holder the $200,000 required to pay the vendor who, on receipt of that sum, released the conveyance and mortgage from escrow. The board, applying *Jones v. Barker* held, that the relevant Bahamas Registration Act did not give the debenture priority over the mortgage because the Act was concerned only with competing dispositions and on the true construction of the debenture and the contract for sale, the debenture was subject to the mortgage and was in no way inconsistent with it; that was true whether the charge in favour of the debenture holder was regarded as a charge on the benefit of the contract or a charge on the legal estate arising on the completion of the contract. In that case there was in effect a tripartite transaction between the vendor, the purchaser and the debenture holder. The debenture holder could never have obtained the release of the conveyance from the vendor without subordinating his debenture to the mortgage.

Mr. McDonnell conceded that the decisions in *Eyre v. McDowell* and *Jones v. Barker* would not avail the purchasers in the present case if the assignment by the vendors to the purchasers was not expressed to be subject to the unregistered tenancy agreement. He submitted that the vendors and the purchasers had agreed a draft assignment which was expressed to be subject to the tenancy agreements and the purchasers were therefore bound by those tenancy agreements. But s. 3(2) of the Ordinance is a special provision of legislation which rendered the options to renew contained in the unregistered tenancy agreements void against the purchasers as soon as the purchasers registered their sale agreement on 18 April 1988. The assignment was not apt to create new obligations by the purchasers to the tenants. As a general rule s. 3(2) of the Ordinance renders void a registrable and unregistered tenancy agreement against a *bona fide* purchaser of a head lease who registers and completes his contract for assignment. The terms of the assignment agreed between vendor and purchaser are irrelevant. The assignment may be drafted so that it does not mention the tenancy agreement. Alternatively, the assignment may be expressed to be subject to the tenancy agreement. Whatever the form of the assignment, the term granted by the head lease vests in the purchaser by force of the assignment subject to the tenancy agreement so far as that tenancy agreement is subsisting and capable of being enforced against the purchaser. In the present case the tenancy agreements are enforceable against the purchaser in respect of the original term but not in respect of the options to renew. There may be special cases in which, by analogy with *Security Trust Co. v. Royal Bank of Canada* (*supra*) the purchaser in effect agrees with the tenant to take subject to the tenant's unregistered interest but this possibility does not arise in the present case.

Also found at [1990] 1 CLJ 1073